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**FOCAL COMMUNICATIONS CORPORATION
OF ILLINOIS**

**Petition for Arbitration Pursuant to
Section 252(b) of the Telecommunications
Act of 1996 to Establish an Interconnection
Agreement with Illinois Bell Telephone
Company d/b/a Ameritech Illinois**

Docket 00-0027

**AMERITECH ILLINOIS' EXCEPTIONS TO
HEARING EXAMINERS' PROPOSED ARBITRATION DECISION**

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Illinois Bell Telephone Company d/b/a Ameritech Illinois ("Ameritech Illinois") respectfully submits its exceptions to the Hearing Examiners' Proposed Arbitration Decision dated April 3, 2000 ("HEPAD").

INTRODUCTION

Ameritech Illinois takes exception to three recommendations in the HEPAD:

(1) the proposal on Issue 1 that Focal be permitted to charge Ameritech Illinois a transport and termination rate of \$.005175 per minute when Focal terminates local telecommunications that originate on Ameritech Illinois' network (HEPAD at 7);

(2) the recommended conclusion on Issue 2 that Internet traffic that Focal delivers to its Internet service provider customers for transmission to distant Internet sites is local traffic subject to reciprocal compensation under section 251(b)(5) of the Telecommunications Act of 1996 ("1996 Act") at the same rate as local traffic (HEPAD at 11); and

(3) the proposal on Issue 4 that Focal not be required to establish a point of interconnection within 15 miles of the rate center for any NXX code that Focal uses to provide foreign exchange service (HEPAD at 16).

Because of the extraordinary importance of Issue 2, Ameritech Illinois addresses it first. The HEPAD recommendation on Issue 2 is contrary to federal law and, as the Commission Staff agrees, would vastly over-compensate Focal for the costs it incurs when it delivers Internet traffic to its ISP customers. Indeed, the rate the HEPAD recommends is nearly four times (388%) the rate Staff proposed as the most accurate measure of Focal's costs. Accordingly, without waiving any argument it has made in connection with Issue 2, Ameritech Illinois offers for the Commission's consideration two alternatives to the inflated \$.005175 per minute rate recommended in the HEPAD: a rate of \$.000946 per minute, which was initially proposed and

supported by Ameritech Illinois, or alternatively, a rate of \$.001333, which was proposed and supported by Staff.

Ameritech Illinois offers substitute language for the HEPAD's recommended Commission Conclusions on Issues 1, 2 and 4 in Attachment A to this submission.

ISSUE 2: INTER-CARRIER COMPENSATION ON ISP TRAFFIC

According to the HEPAD, ISP traffic is "a call utilizing telephone exchange service" and therefore is subject to "the payment of reciprocal compensation to the terminating carrier under Section 251(b)(5) of the [Telecommunications] Act [of 1996]." (HEPAD at 11.) The HEPAD is wrong. In December of 1999, in a decision that is the law and that is controlling here, the FCC held:

[W]e conclude that typically ISP-bound traffic does not originate and terminate within an exchange and, therefore, does not constitute telephone exchange service within the meaning of the [1996] Act. . . . [Rather], such traffic is properly classified as "exchange access."

In the matter of Deployment of Wireline Services Offering Advanced Telecommunications Capability, CC Docket Nos. 98-147 *et al.*, ¶ 16 (Dec. 23, 1999) ("*Advanced Service Order*").

The HEPAD says the FCC has "muddled the waters considerably" with respect to ISP traffic. (HEPAD at 11.) But there is nothing muddy about the FCC's holdings that ISP traffic "does not originate and terminate within an exchange," that it "does not constitute telephone exchange service within the meaning of the [1996] Act," and that it "is properly classified as 'exchange access.'" Nor is there any uncertainty about the proposition that traffic of that sort — non-local, exchange access traffic— is *not* subject to reciprocal compensation under section 251(b)(5) of the 1996 Act. The *Advanced Service Order* is the law, it is controlling here, and so

it will remain unless and until it is set aside by a federal court of appeals.¹ The HEPAD disapproves of the FCC's motive (supposedly "to maintain jurisdiction of the issue"), but the Commission cannot disregard controlling federal law. As the Supreme Court has held, there is no question whether "the Federal Government has taken the regulation of local telecommunications competition away from the states. With regard to the matters addressed by the 1996 Act, it unquestionably has." *AT&T Corp. v. Iowa Utils. Bd.*, 119 S. Ct. 721, 730 n. 6 (1999).²

¹ The FCC also ruled that ISP traffic is non-local in its Declaratory Ruling in CC Docket 96-98 and Notice of Proposed Rulemaking in CC Docket No. 99-68 (*Inter-Carrier Compensation for ISP-Bound Traffic*) ("ISP Order"). The FCC further held in that proceeding that because ISP traffic is not local, it is not subject to the reciprocal compensation provisions of the 1996 Act or the FCC's rules implementing those provisions. On March 24, 2000, however, the United States Court of Appeals for the D.C. Circuit, in *Bell Atlantic Tel. Cos. v. FCC*, Nos. 99-1095 *et al.* ("*Bell Atlantic*") (Exhibit 1 to Ameritech Illinois' Issue 2 Brief), vacated the *ISP Order* and remanded the matter to the FCC for an explanation of the basis for its rulings. As the Commission Staff explained, "the D.C. Circuit's decision does not call into question the FCC's conclusion regarding the character of ISP traffic; rather, it finds that the FCC's articulated basis for its conclusion is insufficient . . . to support that conclusion." (Initial Brief of the Staff of the Illinois Commerce Commission, at 8) (emphasis added). Thus, *Bell Atlantic* has no legal impact on the binding holding of the FCC's *Advanced Service Order* that ISP traffic is exchange access.

The FCC has already signaled that it will provide the explanation for the *ISP Order* that the D.C. Circuit asked for. FCC Common Carrier Bureau Chief Lawrence Strickling stated that he "still believes that calls to ISPs are interstate in nature and that some fine tuning and further explanation should satisfy the court that the agency's view is correct." See Exhibit 2 to Ameritech Illinois' Issue 2 Brief.

² The HEPAD's conclusion that ISP traffic is local exchange traffic, while probably the most glaring mistake the HEPAD makes on Issue 2, is by no means the only one. Section IV of the following discussion explains why the HEPAD is also wrong in concluding that compensation for delivering ISP traffic should mirror compensation for terminating local traffic because there supposedly is no "workable" method for segregating the two types of traffic; in relying on the fact that the two types of traffic function identically on the network as a basis for imposing reciprocal compensation on ISP traffic; and in suggesting that the grounds for Ameritech Illinois' position are not grist for this arbitration, but instead should be raised in other proceedings.

If the Commission decides nonetheless to impose a scheme of inter-carrier compensation on ISP traffic, the Commission should take care not to over-compensate Focal for its costs, as the HEPAD proposal would. Staff agrees that Ameritech Illinois should not be required to pay Focal the \$.005175 per minute reciprocal compensation rate on ISP traffic recommended in the HEPAD, and proposes a rate of \$.001333 per minute. Staff's proposal, as demonstrated below, correctly takes into account two key differences between ISP traffic and local traffic that dramatically reduce the per-minute costs Focal incurs when it delivers ISP traffic: first, the long hold times of Internet calls, which average about seven or eight times as long as local voice calls; and second, the fact that Focal, many of whose ISP customers are collocated at Focal's premises, performs only one switching operation and no tandem-type transport when it delivers Internet traffic to its ISP customers.

Ameritech Illinois has proposed a rate of \$.000946 per minute. Thus, Staff and Ameritech Illinois have proposed rates for inter-carrier compensation on ISP traffic that vary. Both proposals, however, are based largely on the same cost-based principles of compensation. Ameritech Illinois begins by identifying those common principles, and then explains, in Section III, the one difference between Staff's approach and Ameritech Illinois' approach that accounts for the difference between the two proposed rates.

I. AN INTER-CARRIER RATE FOR ISP TRAFFIC MUST TAKE INTO ACCOUNT THE LONG HOLD TIMES OF INTERNET CALLS.

The HEPAD states that ISP traffic and local traffic are functionally identical. That, however, cannot possibly justify the imposition of reciprocal compensation on ISP traffic, because, as further discussed in Section IV below, there are other types of traffic (Feature Groups A and B traffic) that share exactly the same functional traits and that are not subject to reciprocal compensation because, like ISP traffic, they are exchange access traffic. Furthermore, as both Staff and Ameritech Illinois showed in this proceeding, the *cost characteristics* of ISP traffic are radically different from the cost characteristics of local traffic, in ways that must be taken into account in any rational system of inter-carrier compensation for ISP traffic.

The first of these cost characteristics is that ISP calls average approximately seven or eight times longer than local calls, with the result that the per-minute cost of delivering the average ISP call is much less than the per-minute cost of terminating the average local call. The following propositions are uncontested:

- Ameritech Illinois' reciprocal compensation switching rates are per minute rates that assume an average call duration of approximately 3 ½ minutes. (Am. Ex. 2.0 at 14; Am. Ex. 2.5 at 9.)
- Those rates are arrived at by melding two cost streams: (1) set-up costs, which are incurred one time per call and do not vary with the duration of the call; and (2) time-sensitive costs that are incurred over the entire duration of the call. (Am. Ex. 2.0 at 14; Am. Ex. 4 at 4-5).
- Since set-up costs are incurred one time per call, they are melded into Ameritech Illinois' per minute reciprocal compensation switching rates by being spread over the 3 ½ minute assumed duration. (Am. Ex. 2.0 at 14; Am. Ex. 4 at 5.) Thus, for example, if the fixed per call set-up cost were 10¢, then approximately 2.85¢ of

that 10¢ (*i.e.*, $10¢ \div 3.5$) would be assigned to each minute, so that, on average, the full 10¢ set up cost would be recovered on each call.³

- The average ISP call, however, is between seven and eight times as long as the average local call — approximately 26 minutes. (Am. Ex. 2.0 at 14.)
- Consequently, if Ameritech Illinois' reciprocal compensation switching rate were applied to ISP calls, the inter-carrier compensation for the average ISP call would recover between seven and eight times the set-up costs that it should recover. (Using the numbers in the example, a 26-minute call would recover $26 \times 2.85¢ = 74.1¢$ in set-up costs, even though the call actually cost only 10¢ (like all calls) to set up.) (Am. Ex. 2.0 at 14; Am. Ex. 4 at 5-6.)
- Therefore, if Ameritech Illinois' switching rates are going to be used as a starting point for developing an inter-carrier compensation rate for ISP traffic, one necessary adjustment is to re-allocate the fixed set-up cost over the 26-minute duration of the average ISP call. (Again using the numbers in the example, this would mean spreading the fixed 10¢ set up cost over 26 minutes, so that the set-up cost component of the per minute rate would be approximately .385¢ per minute.)

Staff wholeheartedly subscribes to the foregoing analysis. (*See* Staff Ex. 2 at 10-11, 15-16.) For that matter, even Focal does not dispute any of the facts on which the analysis is based. Focal accepts, for example, that Ameritech's switching rates are based on an average 3 ½ minute call; that ISP calls average 26 minutes; and that one component of current switching rates is a fixed set-up cost that has been spread over the average 3 ½ minute call. Focal argues, however, that the 3 ½ minute average call that was used to develop Ameritech's switching rates takes into account the existence of shorter-than-average calls and longer-than-average calls; that ISP calls are not the only longer-than average calls; and that there is therefore no reason to give ISP calls special treatment. (Focal Ex. 2.1 at 6-9.)

³ The 10¢ used in the illustration is much greater than actual call set-up cost, and is used only to simplify the calculations. The point made in the illustration is equally valid regardless of the number chosen to represent the set-up cost.

Focal's argument is shameful. In the first place, ISP calls do not get lumped together (or should not be lumped together) with longer-than average local calls because they are not local calls. The object of the exercise is to come as close as possible to designing an appropriate, cost-based, rate for a special class of traffic that by law is not subject to reciprocal compensation or reciprocal compensation rates, not to enrich Focal by trying to shoehorn ISP traffic into a rate structure that was designed for other traffic that has dramatically different cost characteristics.

In the second place, Focal's premise — that ISP traffic is just one of many types of traffic that could be culled out and called "longer-than-average" — is nonsense. It is ISP traffic, not some other type of traffic, that has grown by more than 450% in the last three years. (Am. Ex. 2.0 at 8.) It is ISP traffic, not some other type of traffic, that has accounted for 100% of the increase in minutes of traffic originated by Ameritech Illinois' residential customers in that same period. (*Id.*) And it is ISPs, not some other customers, that buy 72% of the lines that Focal sells. (Am. Ex. 1.0 at 19 n. 27), so that if a duration of 3 ½ minutes (or even five or six minutes, with ISP calls added to the mix) represents the average call on Ameritech Illinois' network, it certainly does not represent the average call on Focal's network. *If* some other category of calls should emerge in the future that (i) lasts many time longer than local voice traffic; (ii) grows in volume at a rate that dwarfs anything the network has ever seen before; and (iii) is subject to reciprocal compensation by law, then the economics of the situation would warrant a change in the law of reciprocal compensation — especially *if* (iv) it is one-way traffic, like ISP traffic. In this proceeding, though, Focal has called upon the Commission to deal with ISP traffic, and it is pure fantasy to pretend, as Focal does, that ISP traffic is just any old longer-than-average local traffic.

Thus, if a compensation rate for ISP traffic is going to be based on Ameritech Illinois' rates, those rates must be adjusted (as Ameritech Illinois witness Panfil and Staff witness Phipps have done) for the hold times of ISP traffic.

II. A COMPENSATION RATE THAT REFLECTS FOCAL'S COSTS FOR DELIVERING ISP TRAFFIC WILL INCLUDE ONLY ONE SWITCHING ELEMENT AND NO TRANSPORT.

Focal's position that it should be compensated for delivering ISP traffic at the rate proposed in the HEPAD is also preposterous because it assumes that Focal performs two switching operations (end office switching and tandem switching) and tandem-type transport when it delivers traffic to its ISP customers. That assumption, however, is false. Indeed, Staff witness Phipps testified that when Focal delivers traffic to its ISP customers, Focal's network performs one switching operation and no transport, and he explained at length why that is so. (Staff Ex. 2 at 11-15.) Mr. Phipps, an obviously impartial and fair-minded witness, was cross-examined extensively on that testimony, and then reaffirmed it without equivocation:

Q: (By Examiner Woods) Okay, Mr. Phipps, based on all the cross that you went through we are just kind of unclear right now as to what your final position is. Based upon your review of [Focal's] diagram that you discussed with Ms. Hightman has your position now on the recovery of the tandem switching rate changed at all from the position you took when filing your testimony?

A: What I set forth in my testimony is still my position, yes.

Q: And that is your final answer?

A: Yes. I just wish that was for a million dollars.

(Tr. at 578-79.)

Mr. Phipps's final answer was correct. As Mr. Phipps explained in his pre-filed statement, some of the ISP traffic that Focal delivers goes straight to ISPs that collocate in

Focal's switching office. Even Focal witness Barnicle admitted that "the cost of serving customers is less for collocated than non-collocated customers from Focal's perspective." (Tr.112-113.)⁴ That is in part because Focal does not incur any transport mileage for that traffic, as Focal witness Starkey admitted when he proposed, in the fall-back proposal in his Supplemental Verified Statement, to exclude transport mileage charges for such traffic. (Focal Ex. 2.1 at 26.) It is also in part because of the obvious efficiency (*i.e.*, relative cheapness) of routing the traffic, once it has been switched the one and only time that it is switched by Focal, to the collocated ISP equipment in the same building.

When Focal delivers traffic to a collocated customer, Focal merely routes the traffic from its switch to the customer's equipment a few floors away. (Tr. 146-47). For customers that are not collocated, Focal uses high-capacity digital transmission systems to connect customers in "on-net" buildings to Focal's end office switch. (Focal Ex. 2.1 at 14-15). While Focal claims it uses "transport" facilities to do this, the facilities are in fact more akin to the local loop, as Staff witness Phipps testified. (Tr. 539-40). And loop costs (as opposed to inter-office transport costs) are not properly included in a system of inter-carrier compensation. (Tr. 186.)

Mr. Phipps testified that Focal can route Internet traffic to the collocated ISP equipment by means of a simple cross-connect. (Staff Ex. 2 at 11.) Mr. Starkey disagreed, and claimed that Focal serves its collocated customers with an "OC-48 backbone," which, he said, was "about as far removed from a 'simple cross-connect' as one can imagine" and "is likely to require an investment more akin to hundreds of thousand of dollars." (Focal Ex. 2.1 at 12.) That point gets Focal nowhere,

⁴ Mr. Barnicle's admission is corroborated by Starkey Cross-Exhibit 1, which shows that Focal charges its collocated ISP customers less than it charges its non-collocated ISP customers.

however, because the fact remains that Focal performs only the one switching operation. Indeed, this is a perfect illustration of the consequences of Focal's failure to offer a cost study (*see* Section VI below): Focal asks to be compensated for two switching operations (end office switching and tandem switching); the record is clear that it performs only one; Focal says, though, that it is doing something extra with its OC-48; but the closest Focal comes to telling the Commission what that something extra costs is to say that the OC-48 "is *likely* to require an investment more *akin to* hundreds of thousands of dollars." (*Id.*)⁵

Another illustration of the consequences of Focal's failure to offer a cost study can be found in another "correction" that Mr. Starkey made to Mr. Phipps's testimony about collocated ISPs. Where Mr. Phipps testified that "the majority" of Focal's ISP customers are collocated at Focal's central office (Staff Ex. 2 at 11), Mr. Starkey pointed out that a Focal response to a Staff data request indicated that something less than a majority were collocated (Focal Ex. 2.1 at 11). What, though, is the Commission supposed to do with that information? Focal apparently would have the Commission *assume* that the percentage of Focal's ISP traffic that goes to collocated ISPs equals the percentage of ISPs that are collocated. That may be the case, but it also may be that the collocated ISPs receive more traffic on average (or less) than the non-collocated ISPs. A proper cost study would answer that question, and would spare the Commission from having to guess what to do with Focal's admission that it costs less to serve collocated ISPs than non-collocated ISPs.

⁵ Mr. Starkey also uses some sleight of hand to make his case. His vague reference to something "akin to hundreds of thousands of dollars" for an OC-48 conveniently ignores the fact that an OC-48 transmission system can provide more than 32,000 individual connections to Focal's collocated customers. Even if one assumes the OC-48 system requires a \$300,000 investment, that still amounts to less than \$10 per connection, and thus represents a monthly cost that would be only a small fraction of \$10 for each local loop equivalent connection.

It is not only to collocated ISPs, but to all ISPs, that Focal routes traffic with only one switching operation. There can be no serious contention that Focal performs two switching operations, for the simple reason that each ISP call that Focal routes passes through only one Focal switch. (See Focal Ex. 2.1 at 14.) Moreover, Focal does not incur, and therefore is not entitled to recover, transport costs because, as Staff witness Phipps explained, Focal carries traffic to its non-collocated ISP customers via "high capacity facilit[ies], with capabilities to handle large volumes of traffic at a relatively low cost" (Staff Ex. 2.0 at 11; *see also* note 5 above) *and*, in any event, the facilities on which it carries that traffic are not transport facilities, but loops (*id.* at 11-12). As Focal admits, loop costs are not properly recoverable in any inter-carrier compensation scheme. (Tr. 186.)

In sum, as Staff and Ameritech Illinois agree, a compensation rate that reflects Focal's costs for delivering ISP traffic will include only one switching element (not the two switching elements that are included in the proposed HEPAD rate) and (again unlike the proposed HEPAD rate) no transport element.

III. THE COMMISSION SHOULD NOT CREATE BAD PUBLIC POLICY BY ENDORSING AN INTER-CARRIER COMPENSATION SCHEME THAT LETS FOCAL OVER-RECOVER ITS COSTS.

In its March 29, 2000, Order in Dockets 97-0601 *et al.*, this Commission endorsed the principle that inter-carrier rates should track costs as closely as possible. Applied here, that principle would mean that Focal should not be allowed to over-recover its costs. And it is especially important that Focal not be allowed to over-recover its costs in this instance, because even an apparently small per minute over-compensation of Focal will quickly balloon into an enormous subsidy with especially undesirable consequences for the consuming public.

The volume of ISP traffic that originates on Ameritech Illinois' network, and the rate at which it is growing, is staggering. In the period from March, 1997, to October, 1999, while non-Internet traffic on the network grew by just 2.3%, Internet access minutes grew by more than 450% (477% for residential subscribers alone, to a total of 1.9 **billion minutes per month**). (Am. Ex. 2.0 at 8.) With this growth likely to continue (*id.*) on top of the already huge basis of ISP access traffic, an inter-carrier compensation rate that is even a fraction of a cent higher than cost would yield an enormous windfall for Focal and similarly situated recipients of the payments, and an equal forfeiture for Ameritech Illinois.

Such a dislocation, moreover, would benefit people least in need of the benefit, at the expense of those who can least afford to pay for it. (Am. Ex. 1.0 at 23-24.) The subsidy would, of course, benefit Focal and (to the extent Focal's arbitrage profits are passed through) Focal's ISP customers and their subscribers. (Am. Ex. 1.0 at 23-24.) But those subscribers tend to be affluent, and least in need of such a subsidy. (*Id.* at 24.) On the other side of the coin, the ultimate source of the subsidy would be the most disadvantaged ratepayers — those who are not Internet users. (*Id.*)

In addition, a rate that over-compensates Focal, such as the rate recommended in the HEPAD, would disserve every pertinent goal of the Telecommunications Act of 1996. Specifically:

- It would reduce competition among local exchange carriers for residential customers (Ameritech Illinois' Post-Hearing Brief on Issue 2 ("Ameritech's Issue 2 Brief") at 36-37);
- It would encourage market entry by inefficient competitors instead of by efficient competitors (*id.* at 37);
- It would institutionalize irrational pricing of local exchange and Internet services (*id.* at 38-39); and

- It would deny consumers the benefits of emerging technologies by encouraging the use of dial-up Internet access at the expense of more advanced forms of Internet access (*id.* at 39-40).

Thus, if there was ever a case in which the Commission should take care to avoid an over-compensatory rate in order to avoid undesirable social consequences, this is it. Staff's and Ameritech Illinois' proposals for an inter-carrier compensation rate for ISP traffic have much in common, and both come far closer than the HEPAD proposal to being cost-based, fair, and capable of withstanding judicial review.

When Ameritech Illinois responded to Focal's arbitration petition, it tendered this proposal:

- (1) As of the effective date of the parties' agreement, and for three months thereafter, the parties would compensate each other at the rate of \$.001333 per minute for the delivery of Internet traffic to each other's ISP customers. That rate gave Focal the benefit of Ameritech Illinois' end office switching rate (which is higher than the alternative, tandem switching rate), with the set-up component of the rate correctly adjusted to account for the long hold times of ISP calls. (Am. Ex. 2.0 at 14.)
- (2) Because, as discussed in Section V below, the economically correct rate for delivering ISP traffic is actually zero, Ameritech proposed that the \$.001333 rate be reduced to zero over a period of one year. (Am. Ex. 2.0 at 15-16.)
- (3) Finally, because Ameritech Illinois should not be required to pay out all of the revenues it receives for originating Internet access calls while retaining nothing to cover the costs it incurs to carry such traffic, each party's payment to the other for delivery of ISP traffic originated by a particular end user customer of the paying party

would be capped at one-half of the local usage revenues that the paying party derives from that customer. (*Id.* at 16.)

Staff, agreeing with part but not all of Ameritech Illinois' proposal, recommended that the Commission set a rate of \$.001333 per minute, but without the phase-out or the cap proposed by Ameritech. Staff's proposal takes properly into account the long hold times (and therefore lower than local per-minute costs) of switching ISP traffic, and the fact that Focal performs only one switching operation and no tandem-type transport when it delivers Internet traffic to its ISP customers. Thus, Staff's proposal is highly commendable for its recognition that a cost-based inter-carrier compensation rate for ISP traffic will not mirror current reciprocal compensation rates for local traffic, and Ameritech Illinois wholeheartedly endorses the policy underlying Staff's proposal.

Ameritech Illinois, however, has countered Staff's proposal with one that Ameritech Illinois believes comes even closer to the cost-based objective that Staff and Ameritech Illinois agree should be the guiding principle for any inter-carrier compensation rate. While Ameritech Illinois did propose \$.001333 as a starting point for a phase-out process with a cap, that rate is less appropriate as a permanent arrangement for the duration of the parties' agreement, for reasons that Ameritech Illinois set forth in testimony that it incorporates here by reference. (*See Am. Ex. 2.5 at 6.*) Accordingly, Ameritech Illinois responded to Staff's proposal with a revised proposal designed to mitigate Staff's apparent concerns with the rigid phase-out and cap that were part of Ameritech's original proposal, while at the same time coming closer to eliminating the harms, described above, that are inherent in any arrangement that includes inter-carrier compensation for ISP traffic.

The compensation rate that Ameritech Illinois proposes is \$.000946 per minute of use. This rate, which takes into account the ability of Focal and all other LECs to recover at least some of their

costs of serving ISP customers (*see* note 9 below), is equal to the cost of the tandem switching element of reciprocal compensation, adjusted to reflect the impact of a 26-minute average hold time on the allocation of setup and duration costs to a melded per-minute rate. (*See* Am. Ex. 2.0). Ameritech Illinois' proposed rate differs from Staff's in that it is based on the tandem switching element of reciprocal compensation, while Staff's proposal is based on the end office switching element.

There is a second difference between Staff's proposal and Ameritech Illinois', but it does not have to do with the rate *per se*. In Ameritech Illinois view, any compensation rate for ISP traffic that the Commission sets in this proceeding should be subject to prompt adjustment to meet changed circumstances. The rate of change in the telecommunications industry is accelerating each year. Ameritech Illinois believes that even the \$.000946 rate it now proposes is likely to adversely impact the potential for balanced competitive entry for all customer segments, the market potential for advanced services, and untimed calling rates. (Am. Ex. 2.5 at 10.) Evidence of adverse impacts in the next year could be greater than expected by Staff and could warrant a mid-course correction. (*Id.*) In addition, many other foreseeable changes in circumstance might warrant an adjustment to whatever rate the Commission sets here. (*Id.*) Accordingly, Ameritech Illinois submits that in the context of its rate proposal, and in the context of the treatment of this issue in a two-party arbitration rather than in a more broadly-based generic proceeding, it would be prudent to allow for a change to the compensation arrangements applicable to ISP traffic after a period of one year.

Ameritech Illinois therefore proposes that any inter-carrier compensation provisions for ISP traffic in the parties' agreement be subject to renegotiation on 60 days' notice by either party, but with the effective date of any replacement provisions not to precede one year from the initial

effective date of the agreement. The parties would then negotiate a replacement compensation arrangement, subject to the dispute resolution process in the agreement with the ultimate possibility of a resolution mediated or arbitrated by the Commission. In order to remove any incentive for either party to slow down the negotiation process for the new arrangement, the agreement should specify that the replacement compensation arrangement would be applied retroactively (if necessary) to the date of cancellation of the initial arrangement.

Alternatively, Ameritech Illinois proposes that the Commission conduct a generic proceeding on the question of inter-carrier compensation on ISP traffic, as other State commissions are now doing, so that this important question can be addressed in a broad-based proceeding in which all interested parties can participate.

IV. THE COMMISSION MUST REJECT THE HEPAD PROPOSAL ON ISSUE 2.

Regardless whether the Commission adopts Ameritech Illinois' proposal, or Staff's proposal, or some variation on either, it is clear that the Commission should not adopt the decision recommended in the HEPAD.

The HEPAD's rationale on Issue 2 is that ISP traffic is "a call utilizing telephone exchange service" and therefore is subject to "the payment of reciprocal compensation to the terminating carrier under Section 251(b)(5) of the [Telecommunications] Act [of 1996]." (HEPAD at 11.) That is just plain wrong. Section 251(b)(5) of the 1996 Act imposes on local exchange carriers the "duty to establish reciprocal compensation arrangements for the transport and termination of telecommunications." In its regulations implementing the Act, the FCC ruled that section 251(b)(5) applies only to local traffic, that is, "traffic that originates and terminates within a local service area."

47 C.F.R. § 51.701. Thus, ISP traffic would be subject to the reciprocal compensation provisions of the 1996 Act, and to the FCC's rules implementing those provisions, if and only if it were local.

The FCC has repeatedly ruled, however, in an unbroken line of decisions over a period of nearly two decades, that Internet calls are interstate, exchange access calls. Most recently, in December of 1999, the FCC, in its *Advanced Service Order* held:

[W]e conclude that typically ISP-bound traffic does not originate and terminate within an exchange and, therefore, does not constitute telephone exchange service within the meaning of the [1996] Act. . . . [Rather], such traffic is properly classified as "exchange access."

In a word, controlling federal law holds that ISP traffic is exchange access service, and not, as the HEPAD concludes, local exchange service.⁶ And that, in turn, means that ISP traffic is not subject to reciprocal compensation under section 251(b)(5) of the 1996 Act. Thus, if the Commission were to adopt the HEPAD's recommendation on Issue 2, the resulting award almost certainly would not survive review in federal district court.

Beyond its mistaken rationale that ISP traffic is subject to reciprocal compensation under the 1996 Act, the HEPAD says very little in support of its recommended decision on Issue 2. The recommended Commission Conclusion does not say a word about why Ameritech Illinois should compensate Focal seven or eight times over for Focal's set-up costs for ISP calls, as the rate proposed in the HEPAD would require. Nor does it say anything about why Ameritech Illinois should pay Focal for switching and transport costs that Focal does not incur when it delivers traffic to its ISP customers, as the rate proposed in the HEPAD would also require. And the little that the HEPAD

⁶ The *Advanced Service Order* is but the most recent in a string of FCC rulings dating back to 1983 that hold that the service that Internet service providers obtain from local exchange carriers is *exchange access service* that the ISPs use for *interstate* communications. See Ameritech's Issue 2 Brief at 9-13.

does say by way of explanation for its recommended decision falls far short of a justification for the decision. Specifically:

- The HEPAD says (at 11) that ISP traffic is functionally identical to local traffic.

That, however, cannot possibly justify the HEPAD's conclusion that reciprocal compensation should apply to ISP traffic just as it applies to local traffic. In the first place, the undisputed evidence shows that Feature Group A traffic and Feature Group B traffic are "functionally identical" to local traffic in all the same ways, but Feature Group A traffic and Feature Group B traffic are not subject to reciprocal compensation because, like ISP traffic, they are exchange access traffic. (*See* Am. Ex. 1.0 at 13-14.) In the second place, ISP traffic and local traffic are functionally different in one critically important respect: local traffic terminates in the local service area where it originates, while ISP traffic, as the FCC has repeatedly held, does not. In the third place, labeling ISP traffic and local traffic "functionally identical" mistakenly ignores the very different cost characteristics of the two types of traffic — characteristics that must be taken into account whether they are labeled "functional" or something else.

- The HEPAD says (at 11) that "Ameritech's arguments boil down to two predicates," one of which is that "ISP's should be paying access charges to ILECs when they transmit calls to distant websites," and that, "This is a matter for the FCC." That misses the point. Ameritech Illinois is not asking this Commission to do anything about the fact that Focal's ISP customers should be paying some form of access charges but are not; that, obviously, is a matter for the FCC. The point, rather, is that the FCC has repeatedly ruled that ISPs would be subject to access charges except that the FCC has exempted them. That corroborates that ISP traffic is, as the FCC has also held,

interstate, exchange access traffic and not, as the HEPAD holds, local exchange traffic subject to reciprocal compensation.

- The HEPAD also says that Ameritech Illinois argues “that current rates do not reflect reality because the widespread use of the Internet has undermined many of the assumptions . . . that went into setting those rates,” but that Ameritech Illinois should seek redress for such problems in a different proceeding. (*Id.*) Again, the HEPAD misses the point. Ameritech Illinois’ point is not that there is something wrong with Ameritech Illinois’ transport and termination rates for local traffic. Rather, it is that it is irrational to permit Focal, the great bulk of whose business is Internet traffic, to charge for delivering that traffic at rates that were designed for traffic that costs much more to deliver.⁷

- Finally, the HEPAD says that to require Focal to charge Ameritech Illinois differently (or not at all) for delivering ISP traffic would “require the segregation and tracking of ISP bound traffic by the combined efforts of Ameritech and Focal [and] is basically unworkable.” (*Id.*) That plainly does not justify the recommended decision. In the first place, any difficulty in precisely quantifying how much of Focal’s traffic is ISP traffic cannot possibly justify a requirement that Ameritech Illinois pay Focal nearly four times the correct rate (or more) for ISP traffic. At worst, the parties’ best efforts to estimate the volumes of ISP traffic, even if they were off by, say, 10%, would

⁷ The HEPAD does not make entirely clear whether the “current rates” on which it is commenting are Ameritech Illinois’ transport and termination rates or Ameritech Illinois’ local exchange rates. Ameritech Illinois believes the HEPAD is referring to the former. If not, the HEPAD misses the point for a different reason: An across-the-board adjustment in local per-call rates to take into account the additional costs of grossly over-compensating Focal and other CLECs for delivering rapidly-growing volumes of ISP traffic (even assuming the Commission would support such a change, as the HEPAD seems to assume) would result in customers who do not use the Internet (typically, poorer customers) subsidizing customers who make much use of the Internet (typically, richer customers).

obviously be a better solution than to throw in the towel, as the HEPAD recommends, and require Ameritech Illinois to live with overpayments that are orders of magnitude greater than any inaccuracy in measuring their ISP traffic could ever be. Furthermore, State commissions have ruled that incumbent carriers are not required to compensate competing carriers for delivering ISP traffic. (*See, e.g.,* Am. Ex. 1.0 at 20-22.) The carriers in those states are measuring the traffic, and Ameritech Illinois and Focal can do so as well. Finally, Staff explained how the parties could identify and measure ISP traffic. (Staff Ex. 2.0 at 21-22.) The HEPAD apparently claims that Staff's proposal is "basically unworkable" because it would require "the combined efforts of Ameritech and Focal." But if the necessity for combined efforts by ILECs and CLECs were an acceptable basis for rejecting an otherwise acceptable solution, the 1996 Act might as well be repealed.

V. AMERITECH ILLINOIS SHOULD NOT BE REQUIRED TO COMPENSATE FOCAL FOR DELIVERING INTERNET TRAFFIC TO ITS ISP CUSTOMERS BECAUSE AMERITECH ILLINOIS DOES NOT CAUSE THE COSTS THAT FOCAL INCURS WHEN IT SERVES THOSE CUSTOMERS.

In an effort to encourage a resolution of Issue 2 that at least is not patently unlawful and destructive of every pertinent goal of the Telecommunications Act of 1996, Ameritech Illinois has set forth above the reasons that the Commission should, if it is going to set an inter-carrier compensation rate for ISP traffic, adopt Ameritech Illinois' or Staff's proposal in preference to the HEPAD recommendation. At the same time, however, there are two powerful reasons for denying Focal's request for inter-carrier compensation on ISP traffic altogether.

First, a firm that incurs costs to supply services should recover those costs from the customer that caused them. This "cost-causer pays" principle is not in dispute. On the contrary, Focal agrees that "[t]he question to be answered is who is responsible for causing the costs associated with ISP bound traffic." (Verified Statement of Michael Starkey (Focal Ex. 2.0) at 16.)

The cause of the costs associated with ISP traffic lies in a characteristic of ISP traffic that makes it fundamentally different in terms of cost causation from local traffic. That characteristic is this: Every ISP call occurs *because* the ISP subscriber who originates it has purchased services from the ISP which he can use only by employing the local network. Unlike the local exchange customer who uses the local network to communicate with a pizza parlor, a bank or a lawyer, the customer who dials up the Internet has a pre-existing contract with the party whose number he dials pursuant to which (i) he purchases from the ISP a service that by its very nature can be accessed only via the local network; (ii) in order to avail himself of this service, he dials a number that the ISP has given him so he can connect with the Internet through the ISP; and (iii) he cannot use the service the ISP sells him except by dialing that number (or one like it) and thereby making use of the local network.

Thus, as Dr. Robert Harris demonstrated in his Verified Statements (Am. Ex. 1.0 and 1.5), it is the ISP/subscriber relationship that causes the costs of ISP traffic, and there is no basis in economic or public policy for requiring Ameritech Illinois to defray the costs that Focal incurs when it serves its ISP customers.

We demonstrated at length in Ameritech's Issue 2 Brief (at pages 20-30) that Ameritech Illinois does not cause the costs that Focal incurs when it delivers traffic to its ISP customers, and therefore should not be required to reimburse Focal for those costs, and that demonstration is incorporated by reference here. In summary form, Ameritech Illinois showed that

- Focal agrees that the question of inter-carrier compensation on ISP traffic turns on who is responsible for causing the costs associated with that traffic. (*Id.* at 20.)
- When an AOL subscriber clicks the AOL icon on his PC and his modem dials the assigned AOL number to establish an Internet connection, the subscriber performs that cost-causing action because he is a customer of AOL, not because he is a local exchange customer of Ameritech Illinois. And when the carrier that provides AOL access to the network (Focal) delivers the call to AOL and incurs costs to do so, that

happens because AOL has sold Internet access services to its subscriber, not because Ameritech Illinois sold local exchange services to the subscriber. (*Id.* at 21-22.)

- Focal's cost-causation rule, on the other hand — namely, that Ameritech Illinois is automatically responsible for all costs that its local exchange customers impose on the network — makes no sense (*id.* at 25-27) and fails when it is tested against the real world (*id.* at 27-28).
- In addition to the fact that Ameritech Illinois' economic analysis makes sense and matches up with the real world while Focal's rule does not, the Commission should also take into account, as Illinois law counsels, that Ameritech's analysis is supported by a highly qualified economist, while Focal's rule is advocated by a witness with no qualifications as an economist. (*Id.* at 28-30.)

Thus, a correct application of universally accepted economic principles — principles to which this Commission should adhere and normally does adhere in order to advance the public interest and consumer welfare — there should be no inter-carrier compensation on ISP traffic.⁸

⁸ At a bare minimum, Focal should be required to recover *some* of its costs of delivering traffic to its cost-causing ISP customers from those customers. Indeed, the FCC has made clear that the business rates that ISPs pay for access to the network (*i.e.*, the rates Focal's ISP customers pay Focal) are supposed to be a substitute for the access charges the ISPs would otherwise be required to pay. (*See* Am. Ex. 2.0 at 6-7.)

Staff has taken the position that Focal should "have the opportunity to recover" its costs. But if the Commission imposes an inter-carrier compensation scheme designed to cover 100% of Focal's costs for delivering ISP traffic, it will not merely be giving Focal the "opportunity" to recover its costs, but instead will be guaranteeing Focal the recovery of those costs without the need to look to its own customer, the ISP, to provide any portion of the recovery. The basic tariff rates for the types of sophisticated business services (e.g. Primary Rate ISDN services and digital thunking) typically used by ISPs have traditionally been priced well above cost in ILEC tariffs. (Am. Ex. 2.5 at 5.) This is one of the ways that the FCC has always expected the costs of ISP traffic to be recovered under its ESP exemption policy. Given that history, it is reasonable to expect that the rates charged to ISPs by Focal (or any other LEC) should be able to cover at least some of the call delivery costs. (*Id.*)

VI. FOCAL SHOULD NOT BE AWARDED COMPENSATION FOR ITS COSTS OF DELIVERING ISP TRAFFIC IN THIS PROCEEDING BECAUSE FOCAL DID NOT CARRY ITS BURDEN TO PROVE ITS COSTS.

There is another, separate, reason that the Commission should rule against Focal on Issue 2. Focal is asking the Commission to allow it to recover from Ameritech Illinois the costs Focal incurs when it deliver ISP traffic to its customers. The law does not entitle Focal to use Ameritech Illinois' costs as a proxy for its own, because the FCC rule that allows Focal to use Ameritech Illinois' costs as a proxy for purposes of reciprocal compensation (FCC 47 C.F.R. § 51.711) applies only to local traffic. And the FCC has ruled that when a competing carrier cannot use the incumbent's costs as a proxy for its own, the carrier "must prove to the state commission the costs of terminating local calls." *First Report and Order* ¶ 1093; see Ameritech's Issue 2 Brief at 32-35. Focal, though, did not even try to prove what its costs are, and thus placed the Commission in an impossible position. Accordingly, Focal's request would properly be denied even if the Commission were to conclude that Focal should in principle be permitted to recover its costs, or some portion of them, from Ameritech Illinois.

CONCLUSION ON ISSUE 2

The Commission should not adopt the HEPAD's proposed Commission Conclusion on Issue 2. The HEPAD recommendation is legally indefensible, and any and all of the alternatives recommended by Ameritech Illinois and Staff are far more rational and fair. Ameritech Illinois' primary position remains that the Commission should impose no inter-carrier compensation on ISP traffic. In Attachment A to this submission, however, Ameritech Illinois offers language that the Commission could substitute for the HEPAD's recommended conclusion in order to adopt Staff's or Ameritech Illinois' rate proposal or to award no compensation on ISP traffic.

ISSUE 1: FOCAL TRANSPORT AND TERMINATION RATE

Issue 1 concerns the rate Focal will charge Ameritech Illinois when Focal terminates on its network local telecommunications that originate on Ameritech Illinois' network.⁹ Focal contends it should be permitted to charge Ameritech Illinois the composite tandem rate (consisting of the end office, tandem and transport elements of termination) for every such call. (This composite rate is referred to as as the "tandem rate.") Ameritech Illinois, on the other hand, contends that Focal has presented no evidence that for any significant amount of traffic it incurs costs equivalent to Ameritech Illinois' tandem switching and transport costs, and that therefore Focal should be permitted to charge only the lower, end office switching rate or, in the alternative, that only some calls that Focal terminates on its network may qualify for a tandem rate, while others will qualify only for the end office rate, and not for the tandem switching or transport elements.

As the HEPAD notes (at 3), Ameritech Illinois maintains that Focal would be entitled to receive the tandem rate for terminating local traffic only if Focal's switch met two tests: first, it must serve a geographic area comparable to the area served by an Ameritech Illinois tandem switch (the "geographic coverage test"); and second, it must perform functions similar to the functions performed by the Ameritech Illinois tandem (the "functionality test"). Staff agrees. The HEPAD, however, rejects that view of the law and concludes that Focal is required to satisfy only the geographic coverage test, and not the functionality test. According to the HEPAD, the functionality test applies "only where a state commission is desirous of setting disparate reciprocal compensation rates for the transport and termination of traffic depending upon whether the traffic is terminated to an end office

⁹ Issue 1 pertains only to the transport and termination of local traffic, not the delivery of Internet traffic to Internet service providers.

switch or a tandem switch,” and this is not such a case. (HEPAD at 7.) The HEPAD then goes on to find that Focal satisfied the geographic coverage test and is therefore entitled to charge the tandem rate. (*Id.*)

The HEPAD is wrong on the law. Every federal court that has addressed the matter has concluded that a CLEC is entitled to charge the tandem rate only when its switch satisfies both the geographic coverage test and the functionality test. Moreover, this Commission’s precedents conform with that rule. And finally, there is no support in the case law, or in this Commission’s precedents, for the HEPAD’s view that the functionality test applies only in the limited circumstance where the state commission “is desirous of setting disparate reciprocal compensation rates . . . depending upon whether the traffic is terminated to an end office switch or a tandem switch.”

I. FEDERAL LAW HOLDS THAT A CLEC IS ENTITLED TO CHARGE THE INCUMBENT CARRIER’S TANDEM RATE ONLY IF IT ESTABLISHES THAT ITS SWITCH SERVES A GEOGRAPHIC AREA COMPARABLE TO THE INCUMBENT’S TANDEM SWITCH AND PERFORMS FUNCTIONS SIMILAR TO THOSE PERFORMED BY THAT SWITCH.

The federal courts uniformly and without exception treat switch functionality, along with geographic coverage, as the two mandatory tests for determining when a CLEC is entitled to charge the tandem rate for terminating traffic with its switch. The United States Court of Appeals for the Ninth Circuit, for example, in an appeal from a district court review of a State commission arbitration decision, held: “The [State] Commission properly considered whether MFS’s switch performs similar functions and serves a geographic area comparable to US West’s tandem switch.” *US West Communications v. MFS Intelenet, Inc.*, 193 F.3d 1112, 1124 (9th Cir. 1999). The federal district courts agree. *E.g., U.S. West v. Pub. Serv. Comm. of Utah*, No. 97 CV 558, slip op. at 8-9 (D. Utah Nov. 23, 1999) (Exhibit 1 hereto) (holding that “a geographic analysis alone is an insufficient basis

upon which to uphold a rate determination,” and that the rate should be determined by whether [the switch] “functions like a tandem switch, and geography should be considered”); *US West Communications, Inc. v. Minnesota Pub. Util. Comm.*, 55 F. Supp. 2d 968, 978 (D. Minn. 1999) (“in order to evaluate whether a switch performs as a tandem switch [for purposes of warranting the tandem rate], it is appropriate to look at both the function and geographic scope of the switch at issue”); *U.S. West v. Wash. Util. and Transp. Comm.*, No. C97-5686JR, slip op. at 6-7 (W. D. Wash. August 31, 1998) (Exhibit 2 hereto) (holding that FCC requires consideration of functionality and geography, not geography alone); *TCG Milwaukee, Inc. v. Pub. Serv. Comm. of Wis.*, 980 F. Supp. 992, 1003 (W.D. Wis. 1997) (affirming state commission application of functionality/geographic coverage test).

II. THIS COMMISSION’S PRECEDENTS ARE CONSISTENT WITH THE FEDERAL PRECEDENTS.

This Commission’s own decisions in arbitrations under the 1996 Act apply the functionality test, along with the geographic coverage test, to determine whether a CLEC is entitled to charge the ILEC’s tandem rate. In Docket 96 AB-001, an arbitration between Teleport Communications Group, Inc. (“TCG”) and Ameritech Illinois, the Commission arbitrated the question “whether TCG’s switch is to be treated as an end-office switch or tandem switch for purposes of establishing transport and termination prices for traffic originating in Ameritech territory and terminating on TCG’s switch.” (See Arbitration Award, Docket No. 96-AB-001 (Nov. 4, 1996), at 3.) There was no suggestion in the case that the Commission should consider or was considering what the HEPAD here refers to as disparate reciprocal compensation rates depending upon whether the traffic was terminated to an end office switch or a tandem switch. Nonetheless, the Commission applied the functionality test, along with the geographic coverage test:

Section 51.711 (a)(3) [of the FCC's rules] provides that the tandem interconnection rate should be used if the competitive local exchange carrier's switch "serves a geographic area comparable to the area served by the incumbent LEC's tandem switch." *States are also instructed to consider whether new technologies . . . perform functions similar to those performed by an incumbent LEC's tandem switch.* While the pricing provisions of the FCC Order, including Section 51.711 (a)(3), have been stayed, we believe that the factors identified in the FCC Order provide a reasonable basis for resolution of this issue.

(*Id.* at 7¹⁰). In applying the FCC's test, the Commission found that "the record establishes that TCG serves a geographic area comparable to the area served by Ameritech's tandem switch" *and* that "the TCG switch is capable of and will perform both end-office and tandem switching functionalities." (*Id.* at 8.) On that basis, the Commission awarded TCG the composite tandem rate. (*Id.*)

The Commission's decision a month later in an arbitration between MCI and Ameritech Illinois, Docket 96-AB-006, confirms that the CLEC must satisfy both the geographic coverage test and the functionality test in order to qualify for the tandem rate. The issue, as in the TCG/Ameritech Illinois arbitration, was whether MCI was entitled to charge Ameritech Illinois the tandem rate when it transported and terminated local traffic that originated on Ameritech Illinois' network. (Arbitration Award, Docket 96-AB-006 (Dec. 17, 1996), at 10.) And, as in the TCG arbitration, there was no suggestion that the Commission was desirous of setting disparate rates of the sort that the HEPAD here contemplates. In the course of addressing the reciprocal compensation rate issue, the Commission looked to its recent decision in TCG/Ameritech Illinois, and it described its determination there as follows:

that TCG is entitled to the tandem switched termination rate because its switch serves a geographic area comparable to the area served by Ameritech Illinois' tandem switch, *and performs the same functions as a tandem switch.*

¹⁰ The stay to which the Commission referred is no longer in place.

(*Id.*) The Commission then went on to determine that MCI was not entitled to charge the tandem rate, because it had not made a showing like the one that TCG had made. The Commission's discussion of MCI's showing, and the ways in which it fell short of TCG's, again showed that the Commission was considering functionality along with geographic coverage:

TCG was permitted to charge the tandem interconnection rate after consideration of the totality of evidence presented. This included consideration of the fiber-ring technology employed by TCG, (consistent with the suggestion found in ¶ 1090 of the FCC Order), a map showing geographically widespread deployment of various nodes in its network, *testimony regarding the type of switch employed and the various functionalities of the switch*, as well as some discussion of the location of TCG's local exchange customers. *The decision was not premised solely upon the area for which TCG was certificated to serve or the fact that TCG could serve every customer in a given area through its own facilities or unbundled elements, though these were supporting factors.*

(*Id.* at 12.)

III. THERE IS NO PRECEDENT AND NO BASIS FOR THE HEPAD'S NOVEL "DISPARATE RATES" LIMITATION ON THE FUNCTIONALITY TEST.

In sum, every federal court decision and every Illinois Commerce Commission decision of which Ameritech Illinois is aware is consistent with Ameritech Illinois' position that a CLEC must satisfy both the geographic coverage test and the functionality test in order to qualify to charge the tandem rate. Ameritech Illinois is aware of no precedent, on the other hand — and certainly the HEPAD points to none — that is consistent with the HEPAD's conclusion that the functionality test applies only when the state commission "is desirous of setting disparate reciprocal compensation rates for the transport and termination of traffic depending upon whether the traffic is terminated to an end office switch or a tandem switch."

Moreover, the HEPAD's invention of a "disparate rates" limitation on the functionality test is illogical and unreasonable. It is impossible to tell from the HEPAD exactly what the rationale was

for the limitation — the HEPAD says only (at 7) that it is “a fair reading of the relevant portions of the First Report and Order” — but the Hearing Examiners may have had this in mind:

Paragraph 1090 of the *First Report and Order* provides in part:

We find that the “additional costs” incurred by a LEC when transporting and terminating a call that originated on a competing carrier’s network are likely to vary depending on whether tandem switching is involved. We, therefore, conclude that states may establish transport and termination rates in the arbitration process that vary according to whether the traffic is routed through a tandem switch or directly to the end-office switch. In such event, states shall also consider whether new technologies (e.g., fiber ring or wireless networks) perform functions similar to those performed by an incumbent LEC’s tandem switch and thus, whether some or all calls terminating on the new entrant’s network should be priced the same as the sum of transport and termination via the incumbent LEC’s tandem switch.

In the first two of the three quoted sentences, the FCC says that LECs (not just incumbent LECs) are likely to have varying transport and termination costs depending on whether tandem switching is involved and, therefore, that when a State commission sets transport and termination rates for the incumbent LEC and the competing LEC in an arbitration, the State commission may (though it is not required to) establish a higher tandem rate and a lower end office rate for both carriers. If the State commission sets only one rate for the incumbent, then, necessarily, the competing carrier — whose rates are to mirror the incumbent’s rates (*see* 47 C.F.R. § 51.711) — will also have only one rate. But if the State commission sets more than one rate for the incumbent (such as a tandem rate and an end office rate), then in order to determine whether the competing carrier is entitled to charge the tandem rate, the State commission *shall* consider the functionality of the CLEC’s switch.

Ameritech Illinois’ transport and termination rates for local traffic, of course, are already in place, so there was no issue in this arbitration concerning those rates. Plainly, though, since Ameritech Illinois does have more than one rate — a tandem rate, two tandem transport rate

elements, and an end office rate — the FCC’s precept that one must look to switch functionality in order to determine if Focal should be allowed to charge the additional rate for “some or all calls” is fully applicable. The Hearing Examiners, however, *may* have read ¶ 1090 as saying that the functionality test applies only when the State commission “is desirous of” setting more than one rate for the CLEC, even though ¶ 1090 is talking about rates for both carriers, *and even in a case, like this one, where the ILEC already has more than one rate.*¹¹ That cannot possibly be what the FCC was saying, though. When the ILEC comes into the arbitration with more than one transport and termination rate element, there will always, necessarily, be a question whether the CLEC should be permitted to charge the additional rate elements for some of its traffic. This, indeed, is why the HEPAD’s phrase “is desirous of” — which suggests unfettered discretion to set one or more rates — seems so out of place. Yes, the Commission does have some discretion under ¶ 1090, to decide whether to set one rate or multiple rates for the ILEC (when the ILEC’s rates are at issue) and, therefore, to set the same one rate or multiple rates for the CLEC in the same arbitration. But such discretion does not come into play when, as here, the ILEC already has more than one rate. The question, necessarily, is which of those rate elements the CLEC will charge for what traffic, and to answer that question, the FCC directs, the states “*shall* also consider” the functionality test.

In sum, the HEPAD’s “disparate rate” limitation not only has no support in any federal or Illinois Commerce Commission precedent, but also is altogether illogical as applied here. Accordingly, the Commission should reject the HEPAD’s legal conclusion and hold that Focal may

¹¹ Again, we can say only that the Hearing Examiners *may* have read ¶ 1090 in that fashion because the HEPAD sheds so little light on the Hearing Examiners’ rationale.

charge the tandem rate only for such traffic, if any, as it terminates with a switch that satisfies both the geographic coverage test and the functionality test.

IV. FOCAL'S SWITCHES DO NOT SATISFY THE FUNCTIONALITY TEST AND FOCAL THEREFORE IS NOT ENTITLED TO CHARGE THE TANDEM RATE.

Because the HEPAD incorrectly concluded that the functionality test was irrelevant, it did not apply the test to Focal's switches, and there is thus no finding in the HEPAD on whether Focal's switches satisfy the functionality test. Ameritech Illinois therefore simply incorporates by reference pages 3-8 of Ameritech Illinois' Post-Hearing Brief on Issues 1, 3, 4 and 7, which demonstrate why Focal's switches do not pass the test.

Ameritech Illinois directs the Commission's attention in particular, however, to the fact that Focal itself has effectively admitted that its switches do not perform tandem functions.¹² When Focal requested NXX codes for its Chicago switch, it completed an application (Barnicle Cross Ex. 1) that required it to identify all functionalities that switch performed. Focal indicated that its switch performed only end office functionalities. In addition to specifically identifying "end office functionality," Focal also indicated other end office functionalities that its switch performed, including "ISDN office," "Switch 56 kilobit data services," and "Common Channel Signaling." (Tr. 65-67.) Focal did not, on the other hand, indicate that its switch performed *any* tandem functionality. The application offered Focal the opportunity to call out, for example, "Feature Group D tandem," "directory assistance tandem," "Feature Group C tandem," and "Cellular Tandem" as functions that its switch performed, but Focal indicated its switch performed none of those functions. (*Id.*) Thus,

¹² Focal has two switches in Illinois, one in Chicago and the other in Arlington Heights. (Focal Exhibit 1.6)

at a time when Focal had no ax to grind, it declared that its Chicago switch was performing end office switching and not tandem switching.

There is no evidence in the record that suggests that the functionality of Focal's Chicago switch has changed since Focal represented that it performed only end office switching, or that the functions of Focal's Arlington Heights switch differ from the functions of its Chicago switch. Accordingly, the Commission should take at face value what Focal said on Barnicle Cross Ex. 1, when Focal had no reason to be anything but candid and objective, and require Focal to charge only the end office switching rate when it terminates local traffic.¹³

CONCLUSION ON ISSUE 1

The law is clear that Focal would be entitled to charge the tandem switching and transport rates if and only if its switches satisfied both the geographic coverage test and the functionality test. The HEPAD's legal error in recommending otherwise should be corrected. In addition, when the functionality test is applied to Focal's switches, they do not pass the test. Accordingly, Focal initially should be permitted to charge only the end office switching rate when it terminates local traffic that originates on Ameritech Illinois' network, and in the future should be permitted to charge tandem switching and/or transport rates only for the portion of the traffic incoming to its network for which it satisfies the geographic coverage test and the functionality test.

ISSUE 4: POINTS OF INTERCONNECTION FOR FOREIGN EXCHANGE SERVICE.

The HEPAD (at 16) rejects Ameritech Illinois' proposed contact language on this issue, which language would require Focal to establish a point of interconnection ("POI") within 15 miles

¹³ Focal tried at hearing to explain away Barnicle Cross Ex. 1, but the explanation did not wash. See Ameritech Illinois' Post-Hearing Brief on Issues 1, 3, 4 and 7 at 5.

of the rate center of any NXX in which Focal provides foreign exchange ("FX") service. The HEPAD states that "Ameritech's proposal is not required by federal or state law," and that "[t]he Commission does not accept the 'free ride' argument of Ameritech for the reasons provide by Focal." Neither reason is supported by law or the record.

I. THE HEPAD'S CONCLUSION CONFLICTS WITH THE PURPOSE OF THE 1996 ACT.

The HEPAD's conclusion is contrary to the clear purpose of the 1996 Act's interconnection provisions. The 1996 Act requires incumbent LECs to allow interconnection "for the transmission and routing of telephone exchange service and exchange access" between two networks. 47 U.S.C. § 251(c)(2)(A). Focal, however, seeks to force Ameritech Illinois to provide free *interexchange* traffic transport, which is not "the transmission and routing" of either telephone exchange service or exchange access, and which necessarily involves transport on Ameritech Illinois' network for a much longer distance than a local exchange call. Congress and the FCC never intended to allow CLECs to obtain free interexchange transport from incumbents; otherwise, the Act would not focus on the exchange of *local* exchange traffic as the purpose of interconnection. The Commission should enforce the clear purpose of the Act by adopting Ameritech Illinois' proposed contract language.

II. THE HEPAD CANNOT ADOPT FOCAL'S POSITION, AS IT HAS NO RECORD SUPPORT.

Ameritech Illinois presented expert testimony by an economist, Dr. Debra Aron, demonstrating that Focal currently obtains an anticompetitive and uneconomic free ride on Ameritech Illinois' transport network. A "free ride" problem exists because to transmit calls to a Focal FX customer, Ameritech Illinois typically must transport the call over a much longer distance than a local call. Because of the way FX service is designed, however, Ameritech Illinois charges the

originating caller for only a flat-rate local call, and neither Focal nor its FX customer pays Ameritech Illinois for providing interexchange transport for that call. Rather, Ameritech Illinois has to absorb the cost of that transport. This is in contrast to Ameritech Illinois' provision of FX service, where the FX customer is required to pay for such interexchange transport. Thus, Focal and its FX customer receive a "free ride" on Ameritech Illinois' interexchange transport network. (Aron Verified Statement, Am. Ill. Ex. 3 at 13-21). This is the *only* record evidence on the free ride issue, and it is unrefuted. Focal presented testimony by Mr. Tatak on the general FX issue, but he never acknowledges the free ride problem, much less refutes it. Thus, the unrefuted evidence proves that Focal obtains an improper and anticompetitive free ride from Ameritech Illinois. The HEPAD's failure to acknowledge that uncontroverted evidence is inexplicable.

Furthermore, Focal's apparent position on the free ride issue, to which the HEPAD refers (at 16), is nonsensical. Focal effectively concedes that a free ride problem exists for potentially all traffic, not just FX traffic, but claims that it is somehow improper for Ameritech Illinois to address FX traffic only. (See HEPAD at 15). That is absurd. Neither Ameritech Illinois nor the Commission is required to address the whole problem at once. Ameritech Illinois has focused on the FX free ride problem as the most pressing, and the unrefuted testimony shows that Focal is in fact obtaining an improper and unlawful free ride. (Am. Ill. Br. on Issues 1, 3, 4 and 7, at 27). The Commission cannot reject Ameritech Illinois' proposal simply because the proposal could go farther. That would illogically penalize Ameritech Illinois for limiting its request in a manner generous to Focal.

III. THE HEPAD'S CONCLUSION IS UNSUPPORTED.

As explained above, the HEPAD's conclusion on the FX issue is not supported by the law or the facts. Not surprisingly, then, the conclusion itself is extremely vague and devoid of any clear

rationale based on the law or the facts. Rather, the HEPAD simply states conclusions without supporting them or even acknowledging the un rebutted evidence to the contrary. Such cursory findings are deficient as a matter of law. *E.g., Citizens Utility Bd. v. Commerce Comm'n*, 291 Ill. App. 3d 300 (1st Dist. 1997).

For example, the HEPAD (at 16) states that “Focal could be required to construct or lease interconnection facilities, regardless of whether the interconnection was warranted by overall traffic volumes.” That statement entirely ignores Focal’s admission that establishing such interconnection facilities is relatively easy and that there are many companies prepared to provide such facilities at rates equal to or better than what Focal would pay Ameritech Illinois. (Tr. 303-04, 341; Am. Ill. Br. on Issues 1, 3, 4, and 7, at 27-28). Thus, the alleged potential burden placed on Focal by Ameritech Illinois’ proposed language is minimal at most. By contrast, the uncompensated transport costs that Focal continues to foist on Ameritech Illinois under the current arrangement are tangible and substantial and cannot be avoided by Ameritech Illinois by any means other than its proposed contract language. (Am. Ill. Br. on Issues 1, 3, 4, and 7, at 22-24 and 27-28). Thus, the speculative burden on Focal pales in comparison to the existing burden that Focal’s free ride puts on Ameritech Illinois, but the HEPAD never addresses that fact.

Similarly, the HEPAD (at 16) assumes that Focal would need to add POIs where they are not “warranted by overall traffic volumes.” Again, there is no record support for that assumption. Focal’s own witness conceded that Focal might not have to create *any* new POIs to satisfy Ameritech Illinois’ proposed contract language, either now or in the future. (Tr. 329; see Tr. 294-95). Moreover, even if traffic volumes did not initially justify a new POI, Focal obviously would not

begin providing FX service in a new NXX area unless it also intended to add more FX customers in that area.

Finally, the HEPAD summarily rejects, without any explanation, Ameritech Illinois' uncontroverted evidence that Focal is in fact obtaining an improper free ride from Ameritech Illinois through Focal's provision of FX service, at the expense of Ameritech Illinois and its ratepayers, even though that evidence is the *only* record evidence addressing the "free ride" problem.

The HEPAD fails to address these and other matters where the evidence clearly refutes Focal's claims, and therefore cannot stand.

CONCLUSION ON ISSUE 4

The Commission should reverse the HEPAD's conclusion on Issue 4 and adopt Ameritech Illinois' proposed contract language. That result places little or no burden on Focal, while it relieves Ameritech Illinois from providing substantial amounts of uncompensated interexchange transport for Focal's FX customers and thereby subsidizing Focal's competing FX service. This is the only result that ends Focal's current anticompetitive and uneconomic free ride on Ameritech Illinois' network. (Aron Verified Statement, Am. Ill. Ex. 3 at 15-21).

CONCLUSION

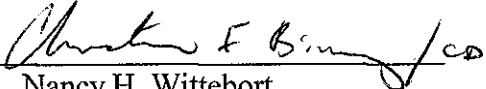
For the reasons set forth above, Ameritech Illinois respectfully urges the Commission to enter an Arbitration Award consistent with the foregoing. Proposed substitute language for the HEPAD's recommended Commission Conclusions on Issues 1, 2 and 4 appears in Attachment A hereto.

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Respectfully submitted,

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